80-1078

Supreme Court, U. S.
FILED
DEC 29 1980
MICHAEL RODAK, JR., CLERK

No. .....

In the Supreme Court of the United States

October Term, 1980

ROLLINS INTERNATIONAL, INC.,
Petitioner,

vs.

MILTON STAUB AND THE OHIO NATIONAL BANK OF COLUMBUS, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI
To the United States Court of Appeals
For the Sixth Circuit

LYMAN BROWNFIELD
140 East Town Street
Columbus, Ohio 43215
(614) 221-5834
Counsel for Petitioner

THE GATES LEGAL PUBLISHING CO., CLEVELAND, OHIO—TEL. (216) 621-5647

QUESTION PRESENTED

Does the existence of corrupt business practices constitute material information required by the federal securities laws to be disclosed by sellers of stock?

LIST OF PARTIES

The defendant-petitioner is Rollins International, Inc. (by change of name now RLC Corp.), One Rollins Plaza, P. O. Box 1791, Wilmington, Delaware 19899. Its attorney is Lyman Brownfield, 140 East Town Street, Columbus, Ohio 43215.

The plaintiffs-respondents are Milton Staub, 17 Meadow Park Road, Columbus, Ohio 43209; and The Ohio National Bank of Columbus, 51 North High Street, Columbus, Ohio 43215 and John L. Davies, Executors of the Estate of Irene D. Hirsch, Deceased, 180 East Broad Street, Columbus, Ohio 43215. Attorneys for the respondents are John L. Davies and John A. Carnahan, 180 East Broad Street, Columbus, Ohio 43215.

TABLE OF CONTENTS

Question Presented I
List of Parties II
Opinions Below 1
Jurisdiction 2
Statutes Involved 2
Statement of the Case 3
Reasons for Granting the Writ 5
Conclusion 10
Appendix:
Opinion of the United States District Court in Case Nos. C2-74-163 and C2-74-249 (Filed September 8, 1977) A1
Memorandum and Order of the United States District Court in Case Nos. C2-74-163 and C2-74-249 (Filed October 11, 1977) A43
Memorandum and Order of the United States District Court in Case Nos. C2-74-163 and C2-74-249 (Filed April 25, 1978) A45
Judgment Entry of the United States District Court in Case No. C2-74-163 (Filed April 25, 1978) A50
Judgment Entry of the United States District Court in Case No. C2-74-249 (Filed April 25, 1978) A51
Order of the Court of Appeals for The Sixth Circuit (Filed September 30, 1980) A53

TABLE OF AUTHORITIES

Statutes and Rules

Securities Exchange Act of 1934:
Section 10, 15 U.S.C. §78j 2, 6, 7
Rule 10b-5 promulgated under the Securities Exchange Act of 1934, 17 C.F.R. §240.10b-5 ..... 2, 6, 7, 8
Section 13(b)(2), 15 U.S.C. 78m(b)(2) 8
28 U.S.C. §1254 ..... 2, 8
Rule 17(c) of the Supreme Court Rules 2, 7

No. .....

In the Supreme Court of the United States

October Term, 1980

ROLLINS INTERNATIONAL, INC.,
Petitioner,

vs.

MILTON STAUB AND THE OHIO NATIONAL BANK OF COLUMBUS, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI
To the United States Court of Appeals
For the Sixth Circuit

OPINIONS BELOW

The Opinion of the trial court is reproduced in the Appendix to this Petition at page A1.

The Memorandum and Order of the trial court amending such Opinion appears in the Appendix at page A43.

The Memorandum and Order of the trial court further amending such Opinion appears in the Appendix at page A45.

The Judgment Entries of the trial court appear in the Appendix at pages A50 and A51.

The Order of the Court of Appeals for the Sixth Circuit is reproduced in the Appendix at page A53.

JURISDICTION

The Order of the Court of Appeals for the Sixth Circuit was entered on September 30, 1980 (A53). The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1) and Rule 17 of the Supreme Court Rules, effective June 30, 1980.

STATUTES INVOLVED

Section 10 of the Securities Exchange Act of 1934, 15 U.S.C. §78j, as amended, provides in relevant part:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange. . .
>
> * * * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5 under the Securities Exchange Act of 1934, 17 C.F.R. §240.10b-5, provides in relevant part:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange

(1) To employ any device, scheme, or artifice to defraud,

(2) To make any untrue statement or a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

STATEMENT OF THE CASE

The two principal shareholders of Gustav Hirsch Organization, Inc. ("GHO") together with a few minor stockholders sold all of the GHO stock to Rollins International, by change of name now RLC Corp. ("RLC"). An integral part of the transaction was a series of employment contracts with GHO management, which management was an essential part of GHO.

Under the direction of its management, GHO had for some time been engaged in a course of commercial bribery. In addition, top management had carried on a course of self-dealing with the company and with the other employees.

None of these practices were disclosed to RLC, including sequelae of the bribery which were handled by top management during negotiations and up to closing of the stock purchase. During the negotiations a senior partner of Taft, Stettinius and Hollister, who was counsel and secretary of a subsidiary of GHO ("Incore"), resigned in writing because Staub, the President of GHO and the

principal seller, refused to disclose the conduct in question to the Internal Revenue Service and other interested parties.

Interesting examples of company documentation regarding the undisclosed practices which prompted the resignation were 3-1/2″ x 5″ "Petty Cash" receipts, respectively for $20,000, $5,000, $5,000 and $3,000. The $20,000 receipt recited that it was for "entertainment".

RLC proffered the testimony of a Coopers & Lybrand partner that the Incore Vice President Bertke had said "if they did not make the payments they could not do business", and that if the names of recipients of the payments were disclosed "they would, in effect, shut them down on the job." In addition RLC proffered testimony of a former supervisory employee of Incore that when confronted with a $20,000 invoice for material never delivered to the job, the same Vice President told him "Don't bite the hand that feeds you." Also proffered was the testimony of a former Incore officer and shareholder that the same Vice President told him, "It's very important in this type of business that—to have payoffs and that this company would never have realized the profits it had had we not made certain payoffs to people." The Circuit Court held that these statements "did not constitute a relevant fact regardless of the truth or falsity of the assertion" (A54).

The negotiations began in the fall of 1968, resulted in a conditional agreement in January 1969, culminating in a June 16, 1969 final agreement based on December 31, 1968 financials. Mr. Weakley's resignation letter was dated January 14, 1969; the Internal Revenue Service problems with two employees involving the payoffs were settled in March 1969 by a GHO purchased cashier's check to the IRS for the benefit of one of the employees and a

written agreement to hold that employee harmless from any further tax liability based on the payments or on the payment of his income tax. None of this was disclosed to RLC or to Price Waterhouse, who did an acquisition audit.

The letter of Leonard Weakley, Esq. to Messrs. Staub and Bertke read in principal part as follows:

> In the course of a conference on January 10, 1969 with Messrs. Milton Staub and Stanley M. Bertke, officers of your company, I was, for the first time, informed of certain financial transactions involving your company which have caused me considerable concern. These transactions were discussed then and in subsequent telephone conversations to an extent sufficient to make it unnecessary to identify or describe them at this time.
>
> Since that conference, I have carefully evaluated the circumstances and situations referred to and have concluded that, unless full disclosure of those and all similar incidents is made to all shareholders of your company, to all parties who or which might have been thereby affected and to the Internal Revenue Service, neither this office nor I, individually, can continue to represent this company and I cannot continue to serve as secretary of your company. Therefore, unless I am advised that disclosure to the extent indicated will be made of all of the transactions referred to above, this letter should be considered to be a termination of representation of your company by this office and as my resignation as Secretary of your company.

The District Court's evaluation of the impact of this letter is set forth in its opinion as follows:

> On or about January 14, 1969, Mr. Leonard Weakley resigned as corporate counsel and secretary of Incore Electric Company. One of the reasons given by Weakley for his resignation was the questionable character of 1966-67 transactions involving Jansen and Murphy which gave rise to the 1969 tax problems. * * *
>
> The Court does not find that the resignation of Leonard Weakley and retention of Milton Bloom were transactions outside the usual and ordinary course of business of GHO or Incore. Weakley's resignation was not caused by the stockholders, but was rather a decision made by Mr. Weakley for the reasons previously discussed. Mr. Weakley's resignation did not raise any additional liabilities for Incore. The resignation was action taken, not by Incore, but rather by Weakley. Since it was not a transaction undertaken by Incore or GHO, it cannot be said that it was beyond the usual and ordinary scope of Incore's business transactions.

In the trial court, the basis for federal jurisdiction of the complaint was diversity of citizenship, the plaintiffs being citizens of the State of Ohio and the defendant being a citizen of the State of Delaware, with an amount in controversy, exclusive of interest and costs, exceeding the sum of $10,000. The defendant's counterclaim arose under §§10(b), 27 and 29 of the Securities Exchange Act of 1934 (15 U.S.C. §§78j, 78aa, and 78cc, respectively), Rule 10b-5 of the Securities and Exchange Commission (17 C.F.R. §240.10b-5) promulgated thereunder, and the pendent jurisdiction of the court.

An appeal from the decision of the District Court entered April 25, 1978 was perfected to the Court of Ap-

peals for the Sixth Circuit. On September 30, 1980, the Circuit Court of Appeals filed its Order affirming the District Court. The Petition for a Writ of Certiorari was duly filed in this Court.

REASONS FOR GRANTING THE WRIT

This Petition meets the criterion for review on certiorari delineated in Rule 17(c) of the Supreme Court Rules. It asks this Court to decide an important question of federal law which has not been, but should be, settled by this Court.

Does the existence of corrupt business practices constitute material information required by the federal securities laws to be disclosed by sellers of stock?

A question of great importance on which this Court has made no direct pronouncement is the materiality of domestic corrupt business practices within the disclosure requirements of §10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. The District Court obviously regarded the existence of such practices as wholly immaterial in a §10(b) context giving consideration only to the application of the contract of sale. The Circuit Court adopted the same approach—describing the trial court's opinion as "well-reasoned and meticulous", and specifically holding that the statements of Bertke as to the necessity of the company's bribery practices "did not constitute a relevant fact regardless of the truth or falsity of the assertion."

If the practice of commercial bribery is a material fact the disclosure of which is required by §10(b) and Rule 10b-5, then disclosure should also be required of the fact that corporate management (and here, sellers of stock, as

well) have made statements that such bribery is practiced and is essential to corporate financial health. Whether or not the assertions are true, knowledge that the management says them is just as material to a prospective purchaser as knowledge of the practices themselves.

The GHO management's refusal to disclose the commercial bribery resulted in the resignation of the legal counsel to Incore, a partner in an established and respected law firm. Dismissing RLC's claims that such non-disclosure violated §10(b) and Rule 10b-5 as unworthy of consideration, the District Court considered it determinative that the resignation of Mr. Weakley did not violate the contractual requirements that business be conducted in normal course between the date of the financial statements and the closing, and that in any event the resignation had caused no damage to GHO.

There are three important voids which need to be filled by a pronouncement of this Court.

The Foreign Corrupt Practices Act (Section 13(b)(2) of the Securities Exchange Act of 1934) requires certain accounting and Securities and Exchange Commission ("SEC") reporting disclosures concerning corrupt business practices, domestic as well as foreign. However, the fact that Congress and the SEC have seen fit to deal with specific matters in a specific way should not permit the implication that corrupt domestic business practices are not material facts required to be disclosed between buyers and sellers without reference to the Foreign Corrupt Practices Act. Absent a declaration by this Court, the case at hand is a step toward just such an implication.

Furthermore, when an SEC reporting company changes auditors, certain information must be disclosed with respect to the change. This requirement may be regarded as

establishing a measure of materiality for application to non-reporting companies as well. No such formal requirement exists with respect to resignation of legal counsel. It is important that the practicing bar and members of management know clearly that when an event occurs such as the resignation of Mr. Weakley, knowledge of it is material to a prospective purchaser with whom negotiations are in progress.

Finally, the distinction between full disclosure and financial reporting according to generally accepted accounting principles needs to be declared in the context of business corruption.

If corrupt practices have depleted a corporate treasury, and the balance sheet accurately shows only the assets which are left, the balance sheet accords with generally accepted accounting principles even if nothing is disclosed concerning the corruption. Further, generally accepted auditing standards do not provide for conducting a fraud audit, and commerce could not stand the burden of fraud audit procedures if they were to become standard. Among other reasons for this is that frequently the roots of fraud extend into prior years, as they did here. It is therefore of great importance to the investment process that sellers and buyers understand that existence of an audit conducted according to generally accepted auditing standards which produces financial statements consistent with generally accepted auditing principles does not satisfy the disclosure requirements of the federal securities antifraud statutes when it leaves undisclosed either internal or external business corruption.

CONCLUSION

For the reasons set forth above, Petitioner urges that its Petition for a Writ of Certiorari be granted.

Respectfully submitted,

LYMAN BROWNFIELD
140 East Town Street
Columbus, Ohio 43215
Counsel of Record for Petitioner

APPENDIX

OPINION OF THE UNITED STATES DISTRICT COURT

(Filed September 8, 1977)

No. C2-74-163

THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

MILTON STAUB,
Plaintiff,

VS.

ROLLINS INTERNATIONAL, INC.,
Defendant.

No. C2-74-249
THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

THE OHIO NATIONAL BANK OF COLUMBUS, AND JOHN L. DAVIES, EXECUTORS OF THE ESTATE OF IRENE D. HIRSCH, DECEASED,
Plaintiffs,

VS.

ROLLINS INTERNATIONAL, INC.,
Defendant.

These actions were brought by the holders of certain debentures issued by the defendant's predecessor in in-

terest. In each of these cases the plaintiffs claim that the defendant has defaulted in the payment of interest on the debentures and that the principal and accrued interest are now due and payable. The defendant has denied that it breached any provision of the debentures and asserts a right to reduce the face amount of the debentures and the interest payable thereon as a result of the plaintiffs' alleged breach of certain contract warranties. In each case the defendant has counterclaimed under theories of securities fraud in violation of the Securities Exchange Act of 1934, and common law fraud.

These cases are before the Court for decision upon the stipulations, the evidence presented at trial, and the briefs and arguments of counsel. This opinion shall constitute the Court's findings of fact and conclusions of law as required by Fed. R. Civ. P. 52(a).

Case No. C-2-74-163 was brought by Milton Staub who holds two 4% subordinated debentures issued by the Rollins Leasing Corporation in the amounts of $255,405.00 and $310,386.00, each dated July 1, 1969. Case No. C-2-74-249 was brought by The Ohio National Bank of Columbus and John L. Davies, executors and trustees of the estate of Irene Hirsch. Rollins Leasing Corporation issued to Irene Hirsch two of its 4% subordinated debentures in the amounts of $313,704.00 and $242,509.00, each dated July 1, 1969. After issuing the debentures in question, Rollins Leasing Corporation amended its articles of incorporation to change its name to Rollins International, Inc. By further amendment of its articles of incorporation, Rollins International, Inc. changed its name to RLC Corporation. The Court will hereinafter refer to Rollins Leasing Corporation and each of its successors in interest collectively as "Rollins" or the defendant. The plaintiffs in each case are referred to collectively hereinafter as the plaintiffs.

The plaintiffs are citizens of the state of Ohio and the defendant is a citizen of the state of Delaware. The amount in controversy, exclusive of interest and costs, exceeds the sum of $10,000.00. The defendant's counterclaim for securities fraud arises under the laws of the United States and states a claim in excess of $10,000.00. The Court has pendent jurisdiction over the defendant's common law fraud claim. The Court finds that the plaintiffs' claim and the defendant's counterclaims arose within this judicial district. Accordingly, the Court finds that it has jurisdiction of the parties and the subject matter of the complaints and of the defendant's counterclaims. Venue is proper in this judicial district.

The debentures were issued pursuant to an agreement and plan of reorganization. This agreement provided for the acquisition by Rollins of all of the outstanding stock of Gustav Hirsch Organization, Inc. (hereinafter "GHO"). The agreement was entered into between Rollins and the shareholders of GHO on June 16, 1969, with the closing to take place on July 1, 1969, and the sale to be effective as of December 31, 1968. At the time the agreement was entered into, Milton Staub held a valid power-of-attorney from all GHO employee-shareholders except Irene Hirsch. Pursuant to this power-of-attorney, Milton Staub negotiated on the behalf of these shareholders and signed the names of various shareholders to the agreements involved in this transaction.

Milton Staub and Irene Hirsch were the two principal shareholders of GHO. The agreement contemplated a total number of outstanding GHO shares of 2,355. Of these, Irene Hirsch held 1,128 shares equalling 47.8980% of the outstanding shares. Milton Staub held 1,006 shares equalling 42.7176% of the total outstanding shares. The distribution of debentures at the closing was made on

the basis of 2,535 outstanding shares of GHO stock. At the time of closing, Milton Staub held 1,188 GHO shares or 46.8635% of the total outstanding shares. The difference between the stock ownership set forth in the June 16 agreement, and that set forth in the July 6, 1969, statement of distribution of debentures is accounted for by the issuance of an additional 180 shares of GHO stock to Milton Staub prior to closing, and the purchase by Milton Staub of the two shares of GHO stock owned by William P. Cline. The stock certificates transferring the Cline shares and reflecting the issuance of the 180 shares to Staub are both dated December 13, 1968.

As part of the agreement, the shareholders of GHO agreed and warranted that Eastmoor Electric Company, Inc. (hereinafter Eastmoor) and Incore Electric Company, which later became Gustav Hirsch Organization, Inc. of Cincinnati, (hereinafter Incore) would be wholly-owned subsidiaries of GHO at the time of closing. Although GHO already owned 100% of Eastmoor, there were some outstanding shares of Incore stock not owned by GHO. The evidence shows that Staub obtained these outstanding shares of Incore stock and sold them to GHO in return for the issuance of the 180 additional shares of GHO stock. Although the corporate minute book does not reflect when these shares were actually issued, it appears to the Court that they were issued sometime after December 31, 1968. The stock certificates were dated December 13, 1968, presumably so that the corporate records would reflect 100% ownership of Incore by GHO on the effective date of acquisition.

The agreement provides for two distributions of the debentures, one distribution at the closing, and the other at the termination of an escrow created by the June 16 agreement. Debentures in the amount of $845,000.00 were

placed in escrow pending a determination of the collectibility of certain questionable accounts receivable. The escrow was terminated in February of 1971 with $545,000.00 of debentures being released to the former shareholders of GHO in proportion to their percentage shareholdings, and $299,998.00 of debentures being returned to Rollins. The authorization for the settlement of the escrow indicates that it is a final settlement of all disputes arising under the escrow agreement, but does not waive or otherwise affect the representations and warranties contained in the agreement of June 16, 1969.

The debentures call for semi-annual interest payments on January 1 and July 1 at the rate of 4% per annum on the unpaid principal amount. By its terms, the principal amount of each debenture becomes due on July 1, 1979. In addition to the default provisions of the debentures which are discussed hereinbelow, the debentures are subordinated, convertible, and callable. Each semi-annual interest payment on the Staub debentures, computed without reductions, would have been $11,315.76. Each semi-annual interest payment on the Hirsch debentures, computed without reductions, would have been $11,124.26. Plaintiffs' complaints do not question any interest payments prior to July 1, 1973. Since July 1, 1973, the interest actually paid by Rollins is as follows:

Date	Staub	Hirsch Estate
July 1, 1973	$ 9,245.97	$ 7,097.22
January 1, 1974	7,414.28	10,620.86
July 1, 1974	10,614.28	10,620.26

Rollins has made no interest payments since July 1, 1974. At the time of trial no payment had been made on any portion of the principal amounts.

Each of the debentures in question contains the following provisions:

> Section 5. *Defaults and Remedies.*
>
> Section 5.1. *Events of Default.* This debenture together with accrued interest thereon shall become due and payable upon demand of the holder hereof if any one or more of the following events (herein called "events of default") shall occur for any reason whatsoever (and whether such occurrence shall be voluntary or involuntary or come about or be affected by operation of law or pursuant to or in compliance with any judgment, decree or order of any court or any order, rule or regulation of any administrative or governmental body) and be continuing at the time of such demand or at the time of a similar demand from the holder of any other debenture, that is to say:
>
> . . .
>
> (b) Default shall be made in the payment of any installment of interest on any debenture according to its tenor when and as the same shall become due and payable and such default shall continue for a period of 30 days . . .

The plaintiffs' complaints allege that the failure of Rollins to pay the full amount of interest claimed due on the debentures constitutes a default which makes the unpaid interest and principal payable on demand. Each of the plaintiffs has properly notified Rollins of the claimed default and has made a demand for payment of the entire principal and unpaid interest accrued thereon. The defendant asserts a right to reduce the principal amount of the debentures, and thereby the interest payable, or to invalidate the debentures and rescind the June 16, 1969, agreement. The defendant's position is based upon alleged

misrepresentations made by the plaintiffs and upon the plaintiffs' alleged breach of warranties contained in the June 16 agreement. The defendant claims that plaintiffs overstated GHO's assets on the December 31, 1968, financial statement by including uncollectible accounts receivable and work in progress, and understated GHO's liabilities by failing to disclose tax liabilities, accounts payable, and recognizable losses. The defendant argues that a reduction in the amount of $516,854.33 in the net assets of GHO as shown on the December 31, 1968, financial statement is required in order to reflect the true financial position of GHO on that date. This adjustment, defendant contends, warrants a reduction in the net debentures issued to Hirsch from $556,213.00 to $326,228.33, and in the Staub debentures from $565,791.00 to $323,574.98. Defendant asserts that it has already paid interest in excess of the interest actually owed when computed on the reduced debenture value, and that it is therefore not in default. The defendant also contends that various alleged misrepresentations and fraudulent omissions made by plaintiffs concerning the operation of GHO and its subsidiaries induced the defendant to enter into this transaction which it would not otherwise have done.

As an additional part of the agreement for the Rollins acquisition of GHO and its subsidiaries, GHO issued to Irene Hirsch a subordinated debenture in the amount of $1,000,000.00, and a ten-year subordinated note payable according to the provisions of subparagraph (S), Section 1, of the June 16, 1969, agreement. Hirsch exchanged her convertible preferred GHO stock and a GHO note in the amount of $1,390,000.00 for the debentures and ten-year note. Rollins guaranteed the payment of both the debenture and note. The defendant now claims a right to void its guarantee as a result of the alleged securities and common law fraud committed by Hirsch. Defendant

further asserts that GHO's obligation to Hirsch should be subordinated to GHO's liability to Rollins in the approximate amount of $3,000,000.00.

After a careful consideration of all the evidence, the Court finds that the plaintiffs are entitled to recovery in this case. The Court does not find that the defendant was entitled to reduce unilaterally the face amount of the debentures, or that the defendant was excused from its duty to perform in accordance with the agreement. The Court does find, however, that the defendant is entitled to a set-off against plaintiffs' recovery as damages for certain breaches of the June 16, 1969, agreement. For the reasons stated herein, the Court also concludes that the defendant is not entitled to recover on its counterclaims.

I

The plaintiffs' evidence clearly shows that Rollins has not paid the interest on the debentures contemplated by the June 16, 1969, agreement, and apparently due and owing from the face of the debentures themselves. Whether this failure constitutes a default which accelerates the debentures depends upon whether performance by Rollins is excused by some provision in the agreement or debentures, or is excused by operation of law. The defendant relies upon §1(Q) of the June 16 agreement which provides in part:

> (Q) That in the event ROLLINS, HIRSCH, or either of the subsidiaries of the latter shall be called upon to pay and do pay any tax deficiency or deficiencies, together with interest and/or penalties thereon, as referred to in subparagraph (O) above and/or pays any liabilities determined to be owing by either HIRSCH and/or any of its said subsidiaries, as re-

ferred to in subparagraph (P) above, the convertible subordinated debentures of ROLLINS to be delivered to Stockholders hereunder, and as hereinafter provided, shall be reduced proportionately among the Stockholders in accordance with their respective stockholdings in said corporations, in a dollar amount equal to any such payments made under either subparagraphs (O) or (P) above by ROLLINS, HIRSCH and/or either of the latter's subsidiaries, as the case may be, and said convertible subordinated debentures shall be reduced proportionately, as aforesaid, in an amount equal to interest at the rate of six percent (6%) per annum of any such payments made from the date of payment thereof. . . .

Subparagraph (O) referred to in subparagraph (Q) contains a warranty and representation by the GHO stockholders that they will be jointly and severally liable and responsible for the payment of any tax deficiency assessed against GHO or its subsidiaries for any tax year prior to the date of closing. Such liability includes all interest and penalties that might be payable in respect of the deficiency assessed. Subparagraph (O) requires that the stockholders "will pay the same to HIRSCH, or as ROLLINS may otherwise direct, within fifteen (15) days after demand is made therefor. . . ." Subparagraph (P) referred to in subparagraph (Q) contains a warranty and representation by the stockholders of GHO that they will be jointly and severally liable in proportion to their respective stockholdings in GHO to "pay ROLLINS all other liabilities (irrespective of the nature thereof) not appearing on the said financial statements of HIRSCH and its said subsidiaries dated December 31, 1968, and dated the date before the closing date hereunder. . ."

The defendant relies upon both subparagraphs (O) and (P) in its reduction of the debentures pursuant to

the authorization granted in subparagraph (Q). Subparagraph (Q), however, contains a condition precedent upon its operation:

> The provisions of this subparagraph (Q) shall be applicable only in the event STOCKHOLDERS fail, refuse or are unable to make any payments payable by them under either subparagraph (O) or (P) above . . .

The authority to reduce the face amount of the debentures under subparagraph (Q), then, operates only after the stockholders have failed or refused to pay liabilities incurred under subparagraphs (O) and (P). The evidence in this case does not show that Rollins at any time made a demand to the stockholders for the payment of any tax deficiencies assessed, or any undisclosed liabilities owed and paid by either Rollins or GHO. Rollins reduced the face amount of the debentures without making a demand of the stockholders and prior to any refusal or failure of the stockholders to pay any amounts allegedly owed under subparagraphs (O) and (P). The Court does not believe that subparagraph (Q) gives Rollins the right to reduce unilaterally the face amount of the debentures upon its determination that the stockholders have incurred a liability under subparagraph (O) or (P). Thus, even if the stockholders became obligated for certain payments under subparagraphs (O) and (P) of the June 16 agreement, the action by Rollins of reducing the face amount of the debentures was not authorized by subparagraph (Q) of the agreement.

The defendant also relies upon subparagraphs (K) and (L) of Section 1 of the June 16, 1969, agreement for its reduction of the debentures. In subparagraph (K) the stockholders warrant and represent that no claims exist or will exist nor any liabilities except such as are shown on the financial statements of December 31, 1968,

and further warrant and represent that such financial statements reflect the true financial conditions of the respective companies on that date. Subparagraph (K) is conditioned, however, that it shall not apply to additional liabilities incurred in the ordinary and usual conduct of the trades or businesses of the corporations. Subparagraph (L) warrants that the total net assets of GHO and its subsidiaries on December 31, 1968, are not less than the amount shown on the audited financial statements prepared by Price Waterhouse & Company, that amount being $288,839.00. The defendant argues that the June 16, 1969, agreement and the July 1, 1969, escrow agreement evidence the intent of the parties that the face amount of the debentures would be reduced in proportion to any reduction in total net assets of GHO from those shown on the December 31, 1968, financial statements arising out of the plaintiffs' breach of subparagraphs (L) and (K). I cannot agree.

Subparagraphs 1(Q) and 6(C) of the June 16 agreement contain specific authorization for the reduction of debentures under certain circumstances. Neither of these sections authorizes a reduction of debentures for reasons other than those specifically set forth. Subparagraph (Q) of Section 1 authorizes the reduction of debentures only under certain circumstances for liabilities arising under subparagraphs (O) or (P). Subparagraph 6(C) relates only to the reduction of the debentures deposited according to the escrow agreement, and only for accounts receivable which were the subject matter of the escrow agreement. Neither of these provisions authorize Rollins to reduce unilaterally the face amount of the debentures for any breach of warranty or representation contained in any other provision of the agreements, specifically those representations and warranties contained in subparagraphs (L)

and (K) of Section 1 of the June 16, 1969, agreement. No other provision of the June 16 agreement, the escrow agreement, or the debentures contains any authorization for Rollins to reduce unilaterally the amount of the debentures for any reason.

Section 9 of the June 16 agreement provides that Rollins may, at its exclusive and sole option, enforce the terms, warranties, covenants and representations of the agreement either by a suit for specific performance of the agreement, or an election to terminate the agreement absolutely. In the event that Rollins should terminate the agreement absolutely, the agreement was to become null and void and neither party was to have any liability thereunder. The reduction of debentures by Rollins does not constitute an absolute termination of the agreement. It is rather an attempted termination of only certain provisions of the agreement and purports to continue the liability of the parties under the remainder of the agreement. The Court does not believe that such authority was intended by the parties to be given to Rollins in this transaction.

When a party to a contract breaches some provision of the contract, the non-breaching party has available to it certain remedies recognized by law, and whatever remedies are specifically agreed upon in the contract itself. The course of action chosen by Rollins in this case was not within the authority provided by the agreement.

II

The only remaining question relating to the plaintiffs' right to recover on their complaints is whether, and the extent to which, Rollins was excused from its duty to pay interest on the bonds under the terms of the agreement by the plaintiffs' alleged breaches of the agreement,

misrepresentations, and fraud. It is well established that a breach by one party to a contract will, in certain circumstances, relieve the other party to the contract from its duty of further performance under the contract. See 6 *Corbin on Contracts* §1252. The defendant has presented its allegations of the plaintiffs' breaches and fraud, both in the form of a defense to the plaintiffs' action on the debentures, and as the basis for its counterclaims. The Court will now turn to a discussion of these matters; first as defenses, and then as counterclaims.

The defendant contends that the plaintiffs have breached subparagraphs (D), (E), (H), (J), (K), (L) and (N) of Section 1 of the June 16, 1969, agreement. Subparagraph (D) warrants that GHO transactions since December 31, 1968, have been restricted to and performed in the ordinary course of the corporation's trade or business, and that no cash or other assets have been withdrawn from the corporation except expenditures made in the ordinary course of its trade and business. Subparagraph (E) warrants and represents that the operations of GHO from June 16, 1969, to the date of closing will be restricted to and performed in the ordinary course of the corporation's trade or business. Subparagraph (H) warrants that the stockholders will provide financial statements prepared and certified by Price Waterhouse & Company for GHO, Eastmoor and Incore on an individual and consolidated basis as of December 31, 1968, and warrants that the certified financial statements which had been provided Rollins as of December 31, 1967, will be and were accurate and complete except for additional liabilities incurred in the ordinary and usual conduct of the trades or businesses of the corporations. Subparagraph (J) warrants that GHO and its subsidiaries will have paid or provided for the payment of all taxes up to December 31, 1968. Subparagraph (K) provides and warrants that

no claims exist or will exist which may be asserted against GHO or its subsidiaries, nor any liabilities except such liabilities as are shown on the financial statements dated December 31, 1968. Subparagraph (K) further warrants that the financial statements represent and reflect the true financial conditions of the respective corporations except for additional liabilities incurred in the ordinary and usual course of business. Subparagraph (L) warrants that the total net assets of GHO and its subsidiaries will not be less than $288,839.00 as of December 31, 1968. Subparagraph (N) warrants that GHO and its subsidiaries have not, to the knowledge of the shareholders, received any notice that they are currently failing to comply with any law, regulation or order applicable to their respective businesses. Each of these alleged breaches will be discussed separately below in the context of the factual circumstances in which they are alleged to have occurred.

Incore Tax Matter

During the first six months of 1969 the Internal Revenue Service notified GHO and Incore that certain adjustments were being made on the 1966 and 1967 income tax returns. In those years certain funds were apparently distributed to Donald Jansen and George Murphy for payment to, and entertainment of, certain unions and business associates of Incore. The evidence supports an inference that certain payments were actually made to Jansen and Murphy. However, Mr. Jansen testified that on two occasions he cashed two checks payable to him in the total amount of $23,000.00 and returned the money to Mr. Bertke, who was vice-president of Incore. He later filled out petty cash vouchers under Bertke's direction for these funds. Mr. Bertke testified in deposition, which was admitted as an exhibit at trial, that he could not remember any such occurrences.

Jansen and Murphy were Incore employees at the times that these payments were made. These employees did not include the sums in question as income on their 1966 and 1967 federal income tax returns. Incore Electric Company deducted the sums involved as ordinary and necessary business expenses pursuant to 26 U.S.C. §162. On March 19, 1969, the Internal Revenue Service disallowed the deduction to Incore under §162 upon a determination that the funds involved did not constitute ordinary and necessary business expenses. The Internal Revenue Service refused to permit a deduction of these sums as business-related entertainment or gift expenses because the company had failed to substantiate the expenses as required by 26 U.S.C. §274(d). As a result of the redetermination of the character of these payments, the Internal Revenue Service added the amount paid to each employee ($61,067.00 to Jansen and $18,104.26 to Murphy) to that employee's ordinary income and made a deficiency assessment for additional tax against Incore. The deficiency of $45,295.72 (including interest) assessed against Incore was paid through a deduction from Incore's outstanding loss carry forward. Jansen and Murphy received at least partial indemnification for their additional tax liability from GHO and Incore.[1]

The defendant contends that these transactions were not conducted in the ordinary course of business of GHO and Incore. The defendant further contends that GHO and Incore had not paid or properly provided for the payment of these federal taxes, and that the plaintiffs had knowledge that Incore had been found to be in noncompliance of the tax laws. Finally, the defendant con-

---

1. Although Incore assumed the obligation to reimburse Jansen and Murphy for the tax deficiencies, the Jansen deficiency of $17,488.00 was paid in 1969 by a cashier's check purchased by GHO.

tends that the tax liability of Incore, and the indemnification of Murphy and Jansen were liabilities which were not disclosed on the December 31, 1968, financial statements. The plaintiffs respond that each of the transactions involved in the Incore tax liability was in the ordinary course of business. The plaintiffs further point out that the deficiency was not assessed until the early part of 1969, and that it therefore need not have been reflected as a liability on the December 31, 1968, financial statements. It is the plaintiffs' position that the taxes due and owing as of December 31, 1968, had been paid, and that the tax liability which came to the plaintiffs' attention in the early part of 1969 was protested by Incore and had not been resolved on that date of closing.

The evidence presented at trial supports an inference that the payments to Jansen and Murphy in 1966 and 1967 were outside the ordinary course of Incore's trade or business. The tax consequences of a non-business transaction are also non-business in character. The Court finds that, given the character of the payments made in 1966 and 1967, the liabilities incurred in 1969 to Jansen and Murphy were outside the ordinary course of business contemplated by the parties in Section 1, subparagraphs (D) and (E) of the agreement. The Court further finds that the liability to IRS constitutes a tax deficiency for a tax year prior to the date of closing, for which the former GHO shareholders assumed responsibility pursuant to Section 1(O) of the June 16, 1969, agreement.

In the June 1969 agreement the GHO shareholders warranted against such non-business liabilities. The Court does not find, however, that plaintiffs' breach went to the whole of the contract. See 6 *Corbin on Contracts* §1253. Thus, Rollins is entitled to damages for plaintiffs' breach, but Rollins is not excused from its duty to perform

under the contract by reason of plaintiffs' breach. See 3A *Corbin on Contracts* §709.

Subparagraphs (O) and (P) of Section 1 of the June 16, 1969, agreement provide Rollins with a remedy which it could have asserted against the stockholders for both the Incore tax liability and the indemnification of Jansen and Murphy. Rollins chose not to make demand upon the stockholders for payment of the tax deficiency or for payment of the Jansen and Murphy liability, but instead unilaterally reduced the face amount of the debentures to cover these expenditures. This reduction did not occur until January of 1974, when Rollins paid the interest for the six month period ending December 31, 1973. Rollins failed to follow the remedies provided therein for such a breach; Rollins therefore failed to meet the contractual prerequisites for the reduction of debentures authorized in subparagraph (Q) with respect to these items.

Since the tax deficiency assessment against Incore was not made until 1969, the Court finds that it was not feasible for this liability to have been shown on the financial statements as of December 31, 1968. As of the end of 1968, Incore had paid all taxes then known to be due and owing. Following the initial protest of the tax deficiency, payment of the increased liability was provided for by a reduction in Incore's loss carry forward. This matter was still in dispute on the date of closing, and cannot fairly be characterized as notice to the stockholders that GHO or Incore was in non-compliance with any law or regulation.

Plaintiffs contend that the defendant was not damaged by the deficiency assessment against Incore since the defendant was never able to take full advantage of the entire loss carry forward. In subparagraph (O) of Section 1 of the June 16 agreement, however, the GHO stockholders promised that they "shall be responsible for the payment

of all of any such additional tax" assessed against GHO or its subsidiaries for any tax year prior to the date of closing. The Court finds that the parties intended that the GHO stockholders were obligated to pay any pre-1969 tax liability. After the Incore deficiency was assessed, the defendants caused the increased tax liability to be paid by a reduction of the outstanding loss carry forward. Although this payment did not require a cash expenditure, it did cause a diminution in an Incore asset. The manner in which the tax deficiency was paid is immaterial; the important fact is that it was paid. Since the plaintiffs assumed the liability for such tax payments; and payment was made by defendant, the defendant is entitled to recover the amount of the increased tax liability from plaintiffs. The fact that the defendant ultimately incurred no economic detriment as a result of the tax payment is a fortuitous circumstance from which plaintiffs are not entitled to benefit.

On or about January 14, 1969, Mr. Leonard Weakley resigned as corporate counsel and secretary of Incore Electric Company. One of the reasons given by Weakley for his resignation was the questionable character of 1966-67 transactions involving Jansen and Murphy which gave rise to the 1969 tax problems. Thereafter, Milton Bloom assumed the representation of Incore. Mr. Bloom was paid approximately $1,200.00 by Incore for legal services which included, among other things, work relating to the 1966 and 1967 income tax liability of Donald Jansen and the Staub acquisition of Incore stock.

The Court does not find that the resignation of Leonard Weakley and retention of Milton Bloom were transactions outside the usual and ordinary course of business of GHO or Incore. Weakley's resignation was not caused by the stockholders, but was rather a decision made by

Mr. Weakley for the reasons previously discussed. Mr. Weakley's resignation did not raise any additional liabilities for Incore. The resignation was action taken, not by Incore, but rather by Weakley. Since it was not a transaction undertaken by Incore or GHO, it cannot be said that it was beyond the usual and ordinary scope of Incore's business transactions.

The payment of Milton Bloom's legal fees does not disclose a separate amount attributable to his efforts in consummating Staub's acquisition of Incore stock. Staub's purpose in acquiring the Incore stock, however, was to in turn transfer it to GHO in order to consummate the proposed acquisition by Rollins. This acquisition was for the benefit of GHO and Incore, as well as for the benefit of the individual stockholders. In light of the relatively small amount of money involved, and the relationship of the stock acquisition to the pending Rollins acquisition, I do not believe that the payment to Milton Bloom constitutes a material breach of any warranty contained in the June 16 agreement.

Briefly stated, I do not believe that the various transactions arising out of the so-called Incore tax matters constituted material breaches of the June 16, 1969, agreement which would relieve Rollins of its duty to perform under that agreement and according to the terms of the debentures issued. The Court will discuss the defendant's damages for the plaintiffs' breach hereinafter.

Bird & Son

The defendant next asserts that the financial statements of GHO and Incore as of December 31, 1967, and December 31, 1968, failed to recognize and record certain liabilities in violation of the warranties in subparagraphs (H) and (K) of the June 16, 1969, agreement. The first

such liability is a back-charge to Bird & Son in the amount of $89,671.31, and a loss on the Bird & Son contract in the amount of $197,306.41.

The Bird & Son contract involved construction at the Kamphaeng Saen Air Force Base in Thailand. Bird & Son was the general contractor, and GHO was the electrical contractor on this United States government project. Various problems were encountered on this project, and the contract eventually resulted in a substantial loss to both Bird & Son and GHO. The defendant asserts that the financial statements of GHO as of December 31, 1968, failed to disclose an $89,671.31 back-charge as a liability owed to Bird & Son on this contract.[2] The back-charge in this case came about as a result of GHO's inability to supply certain equipment for the project which it was obligated to supply, and which was included in the original contract price. Bird & Son acquired the necessary equipment and supplied it to the project at a cost of approximately $89,000.00. Bird & Son invoiced GHO for this amount, but the defendant did not discover the invoice until January of 1975. The invoice was not reflected on the December 31, 1968, financial statements nor the Price Waterhouse audit.

The defendant analyzes the effect of the back-charge with the assumption that all receivables were in fact received. The defendant contends that the proper accounting for this back-charge is to reduce the contract price by the amount of the back-charge. This in turn requires the reduction of future billings from the approximately

---

2. In a typical construction contract, a subcontractor performs services and payment is made to the subcontractor for those services by the general contractor. A "back-charge" is a liability incurred under the contract by the subcontractor to the general contractor which is "charged back" against the subcontractor's right to payment under the contract.

$100,000.00 shown on the December 31 financials to approximately $11,000.00. According to the December 31, 1968, financial statements, there remained approximately $76,000.00 in additional costs necessary to complete the Bird & Son project. Following the defendant's analysis, an additional $76,000.00 would be required to be expended in order to collect the remaining $11,000.00 billable on the contract. The end result then is a $65,000.00 loss. The plaintiffs argue that the back-charge was not a liability, but was rather a payment on the contract by Bird & Son in kind rather than in cash. The plaintiffs contend therefore that it does not reduce the contract price and it was not necessary to show the back-charge as a liability on the financial statement.

The Court does not find that the back-charge constitutes a liability that was required to be reflected on the December 31, 1968, financial statements. Whether the $89,000.00 worth of equipment supplied by Bird & Son is considered to be a reduction in the contract price or a payment on the contract in kind is immaterial. The fallacy that I find in the defendant's analysis is the failure to deduct the $89,000.00 from the cost necessary to complete the contract. If, as the defendant contends, the $89,000.00 worth of equipment supplied by Bird & Son reduces the total contract price and GHO's future billables, it also constitutes $89,000.00 worth of equipment that GHO was no longer required to supply to the project. Subtracting the $89,000.00 from GHO's remaining contract cost reduces the future cost to a negative value and renders the remaining future billings as a profit on the contract. Since the $89,000.00 worth of equipment was originally included in both the contract price and in GHO's total cost, a reduction in the contract price requires a corresponding reduction in GHO's cost. Otherwise, it appears to the Court, the defendant would have GHO paying for

this equipment twice: once as a reduction in the contract price because the equipment was not supplied by GHO, and again as a cost of completing the project because it was required to be supplied by GHO.

Before turning to the loss incurred on the Bird & Son contract, it is necessary to identify one aspect of GHO's bookkeeping practices. GHO's accounting was conducted on a completed contract basis. This means that profit on a given job was not recognized until the job was closed and the contract was deemed completed. Loss on a contract under the completed contract basis is recognized as soon as the loss becomes apparent and the amount of the loss can be reasonably ascertained. It is the defendant's position that a loss was readily ascertainable on the Bird & Son contract as of December 31, 1968, and thus should have been included on GHO's financial statements for that date. The plaintiffs contend that there were no facts in existence as of December 31, 1968, from which GHO could have reasonably concluded that the Bird & Son contract would end in a loss. Plaintiffs further contend that all of the events upon which Mr. Feeney, a Rollins accountant and officer of GHO, relied in calculating the loss on the Bird & Son contract occurred after December 31, 1968, and cannot therefore be related back to the financial statements as of that date.

The December 31, 1968, financial statement showed accounts receivable on the Bird & Son project of $81,331.00, and a retainage held by Bird & Son in the amount of $161,948.00.[3] Bird & Son held back a retainage of 30% on the payments to GHO under the contract due to GHO's

---

3. In some construction contracts the owner or general contractor withholds a certain percentage of each contract payment made to subcontractors to secure continued performance of the contract. The amount withheld is called a "retainage" and is normally paid upon successful completion of the contract.

inability to provide bonding on the project. GHO's inability to provide bonding was caused by the fact that the project was situated in an undeclared war zone. GHO's books also showed a billing in excess of cost as of December 31, 1968, in the amount of $64,595.00. The total value of the contract as of December 31, 1968, is then computed as approximately $179,000.00 (accounts receivable plus retainage less billing in excess of cost). The defendant computes the loss on the Bird & Son project by adding to the $179,000.00 total contract value the back-charge composed of unrecorded invoices from Bird & Son in the amount of $89,000.00 and subtracting therefrom the post-1968 payments from Bird & Son in the approximate amount of $71,000.00. The defendant's computations do not include a $55,000.00 payment received by GHO in compromise of certain claims which the defendant contends were outside the contract. Notwithstanding the defendant's contention that a $197,000.00 loss was recognizable on the Bird & Son project as of December 31, 1968, the September 30, 1970, profit and loss statement for GHO shows the Bird & Son contract as a completed contract with an anticipated profit of approximately $18,000.00. This profit and loss statement includes, however, an account receivable from Bird & Son in the amount of approximately $242,000.00, of which approximately $127,000.00 is listed as being pending for 90 days and over and approximately $114,000.00 is listed as retainer.

In examining the testimony of the witnesses and the exhibits submitted at trial, the Court can find no credible evidence which supports defendant's position that a loss was recognizable on the Bird & Son contract as of December 31, 1968. The fact that all of the accounts receivable and retainage carried on GHO's books as of that date were not eventually collected, does not support the inference that these amounts were known to be uncollectible

as of December 31, 1968. The evidence shows that six payments were made by Bird & Son on this contract during the year 1968, the latest being November 6, 1968. These payments totalled approximately $148,000.00. The evidence fails to show why GHO and its officers should have known as of December 31, 1968, that this course of payments by Bird & Son would not continue during the year 1969, and thereafter.

I do not find that the treatment of the Bird & Son contract on the financial statements of GHO as of December 31, 1968, constitutes a breach of any of the provisions in the June 16, 1969, agreement. The ultimate loss on this contract need not have been reported as a liability, nor was it a breach of warranty to include Bird & Son in the December 31, 1968, accounts receivable. The backcharge, previously discussed, did not constitute a liability nor was it a claim which existed which may be asserted against GHO.

White Motor Company Invoice

The defendant next contends that plaintiffs breached subparagraph (K) of Section 1 of the June 16 agreement by failing to record on the December 31, 1968, financial statements a liability and potential claim involving an account payable to White Motor Company in the amount of $43,347.20. This account payable was apparently removed from GHO's books sometime during the year 1967, although it had not been paid. Accordingly, this amount was not shown as a liability on the December 31, 1968, GHO financial statement. Thereafter, White Motor Company asserted its right to payment, and was in fact paid by GHO in May of 1970. No plausible explanation has been offered to justify the removal of the White Motor Company account payable from GHO's books in 1967, or

to support a finding that it was not in fact a valid liability as of December 31, 1968. The Court therefore finds that the failure to include the White Motor Company account payable on the December 31, 1968, financial statements constitutes a breach of subparagraph (K) of Section 1 of the June 16, 1969, agreement. In so finding, however, I do not believe that this breach went to the whole of the contract or was of such a character to relieve the defendant of its duty to continue performance under the contract. See 6 *Corbin on Contracts* §1253. Although the defendant is entitled to recover damages for the plaintiffs' breach, in light of all the circumstances, this breach does not discharge the defendant's duty of performance. See 3A *Corbin on Contracts* §709. The set-off against plaintiffs' recovery is discussed hereinbelow.

Ohio State University

The defendant asserts that the plaintiffs breached the June 16, 1969, agreement by failing to record as a liability a loss of $151,500.00 on a contract with The Ohio State University. The defendant also claims that plaintiffs erroneously included on the December 31, 1968, financial statements accounts receivable on the OSU project in the amount of $103,160.00 and, as work in progress, an asset in the amount of $100,059.00. The OSU contract refers to the construction of two dormitory towers at The Ohio State University upon which GHO was the electrical contractor. The construction was started in the spring of 1965 with completion originally estimated for the fall of 1966. In the spring of 1966, due to several problems including labor strikes, it became apparent that the entire project on both towers would not be completed by the fall of 1966. In an effort to open at least a portion of the dormitories by the beginning of the fall quarter 1966, the prime contractors and owner agreed to certain changes and extra

expenditures on the project. The owner agreed to pay overtime if the contractor gained the approval of the architect. Although GHO made no request for the approval of overtime, an amount for overtime was included in an August 1966 letter from GHO to OSU. This letter did not constitute a formal claim on the contract, but was to advise OSU of the additional cost incurred by GHO on the project. The OSU dormitories were finally completed in the spring of 1967. In early 1971 GHO made a formal claim to OSU in the approximate amount of $365,000.00, including the unapproved overtime. This claim was denied as unmeritorious and untimely. At the time of trial the dispute between GHO and OSU was still in litigation, and OSU continued to hold a substantial retainage on the contract.

At the suggestion of Price Waterhouse & Company, GHO included on its December 31, 1968, financial statement a reserve in the amount of $175,000.00 for the anticipated loss on the OSU contract. With the inclusion of the $175,000.00 reserve, the Court finds that the accounting afforded the OSU contract on the December 31, 1968, financial statements reflected what could reasonably be anticipated as the final settlement on that contract at that time. The reserve established does not appear to the Court to have been an unreasonable amount in the early part of 1969. The reserve further serves as a warning on the financial statement that all of the accounts receivable and assets listed as work in progress may not be finally realized. I find no breach in the plaintiffs' treatment of the OSU contract on GHO's financial statements as of December 31, 1968.

The Court takes judicial notice of the fact that, while this case has been under advisement, judgment was rendered by the Ohio Court of Claims in favor of GHO on

the OSU contract in the amount of $140,000.00 plus interest at 6% from October 1967 to the date of judgment.

Port Huron/Vogel

The defendant's next contention is that the plaintiffs listed assets on the December 31, 1968, financial statement with respect to a construction project at a paper mill in Port Huron, Michigan, which were not in fact proper assets. The two assets consisted of an account receivable in the amount of $35,654.00 and work in progress, or cost in excess of billing, in the amount of $29,897.00. The defendant also contends that this transaction was outside the ordinary course of Incore's business. Incore Electric Company received the electrical contract for the installation of electric equipment at the No. 8 paper mill in Port Huron, Michigan, on June 17, 1968. After commencement of work on the contract it appeared that an out-of-state contractor would have difficulty obtaining the labor necessary to complete the contract. Stanley Bertke of Incore was aware that a Port Huron electrical contractor had submitted a late bid for the same project at a substantially lower price. Bertke therefore contacted the local contractor, Vogel Electric Company, and it was agreed that Incore would subcontract the completion of the electrical work to Vogel. Incore required and was supplied a performance bond and material and labor bond written by the Aetna Casualty Company.

The general conditions of the contract between Incore and the general contractor Darin & Armstrong required the general contractor's written permission for the subcontracting of any work. Incore did not obtain the permission of Darin & Armstrong to subcontract to Vogel Electric, but in a September 12, 1968, letter advised Darin & Armstrong that Incore and Vogel had consummated a joint venture agreement for the completion of the paper mill

project. On November 12, 1968 Darin & Armstrong advised Incore Electric that they had not approved the assignment or subletting of the contract to Vogel. Darin & Armstrong indicated a willingness to consider a joint venture between Incore and Vogel provided that they were provided with a copy of the joint venture agreement. Although there is no evidence that Incore ever provided Darin & Armstrong with a copy of the agreement between Incore and Vogel, Vogel's continued work on the jobsite until June of 1969 was known to Darin & Armstrong. The subcontract to Vogel appears to be a matter between Incore and Darin & Armstrong and is not relevant to the issues raised in this case.

Vogel Electric was apparently operating with insufficient working capital and neither the general contractor nor the owner were satisfied with the progress being made on the Port Huron paper mill. In April 1969 Aetna, the surety, agreed to finance the completion of the Port Huron contract. Thereafter Incore made payments to Aetna rather than to Vogel. In May 1969 Incore agreed to limit Aetna's liability to the face amount of the performance bond. In early June 1969 Aetna ceased financing Vogel when Vogel abandoned the job. At that point Incore took over the project and completed it to the satisfaction of the general contractor and owner.

The evidence supports a finding that Incore and GHO knew or had reason to know that there were problems concerning the Port Huron contract, both with labor and with Vogel Electric Company. These problems were apparent during the year 1968. The extent of these problems became clear in the early part of 1969 when Aetna took over the financing of Vogel Electric, and subsequently ceased financing on the project. The evidence does not, however, support the defendant's contention that the accounts receivable and work in progress listed on the De-

cember 31, 1968, financial statement were improper assets. The problems known at the end of the year 1968 were not of such character as to suggest that Vogel would be unable to complete the project or that Incore would be unable to collect the full contract price. Even in 1969 when Vogel withdrew from the project, it was reasonable for Incore and GHO to assume that Aetna would perform in accordance with the surety agreement. The Court finds, therefore, that plaintiffs did not breach the June 16, 1969, agreement by the inclusion of the Port Huron items on the December 31, 1968, financial statements of GHO and Incore. Although there were problems with the Port Huron contract, the Court does not find that the nature or severity of these problems placed this transaction outside the normal scope of GHO's and Incore's business.

Transamerica

The defendant's next allegation of plaintiffs' breach of the June 16, 1969, agreement relates to the account receivable listed for the Transamerica contract. On the December 31, 1968, financial statements, the Transamerica contract was listed as an account receivable in the amount of $21,282.61. A reserve for doubtful accounts receivable in the amount of $5,000.00 was established on this account. Subsequent collections amount to $11,000.00. The defendant therefore claims a net reduction in the debentures held by plaintiffs in the amount of $5,283.00. The only reason given by the defendant for this reduction is the fact that the total account receivable minus the established reserve was not in fact collected. The Court can recall no evidence which supports an inference that the Transamerica account receivable was known to be uncollectible as of December 31, 1968.

Net Worth

The June 16, 1969, agreement provides in subparagraph (U) of Section 1

> that all income or losses realized or suffered from the operation of HIRSCH and its subsidiaries, from January 1, 1969 to the date of closing hereunder, shall accrue to and be exclusively for the account of ROLLINS.

The Court believes that many of the losses and uncollected accounts receivable discussed in the foregoing portion of this opinion fall within the category of "losses realized or suffered from the operation of Hirsch and its subsidiaries" after January 1, 1969. Under generally accepted accounting principles the fact that a contract ultimately results in a loss does not mean that the contract cannot be properly listed on financial statements as having an anticipated net profit. Nor does the fact that an account receivable ultimately becomes uncollectible mean that it is not a valid account receivable at some earlier time. Under GHO's accounting practices a loss or uncollectible account receivable need not have been reflected on the financial statements until the loss or uncollectibility became reasonably certain. The parties agree that the plaintiffs did not warrant that all the accounts receivable and anticipated profits would be fully realized, but only that they were valid as of December 31, 1968.

In subparagraph (L) of Section 1 of the June 16, 1969, agreement, the shareholders of GHO warranted that the consolidated net worth of GHO and its subsidiaries would not be less than $288,839.00. The defendant contends that the net liabilities as of December 31, 1968, were understated in the amount of $285,949.33, the net accounts receivable were overstated in the amount of $100,940.00, and the net value of work in progress was over-

stated in the amount of $129,956.00. The defendant therefore asserts that the net assets of GHO and its subsidiaries as of December 31, 1968, was a deficit of $228,015.33. Because the Court cannot agree with the defendant's adjustments to the December 31, 1968, financial statement, the Court cannot agree with the defendant's computation of the net assets of GHO and its subsidiaries. While the Court has agreed with certain contentions made by the defendant, plaintiffs' breaches do not go to the heart of the agreement, and do not relieve the defendant of its duty to perform. A financial statement is a statement of a company's financial condition as of a particular point in time. The Court believes that the financial statement of GHO and its subsidiaries as of December 31, 1968, was a reasonably accurate reflection of the financial condition of these companies as of that date. Such financial condition is, of course, subject to change, and subsequent events may require that certain items be accounted for differently in future financial statements. This does not, however, make the December 31, 1968, financial statement a misrepresentation of the company's financial position as of the date of its preparation.

Not all of the inaccuracies ultimately shown to exist on the December 31, 1968, financial statements were favorable to the plaintiffs. The evidence shows that some contracts resulted in higher profits or lower losses than anticipated. The evidence also shows that some doubtful accounts, for which reserves were established, were in fact collected. Thus, while some assets on the financial statement may have been overstated, and some liabilities understated, it also appears that some assets were understated and some liabilities overstated. On balance, I cannot find from the evidence that the consolidated net worth of GHO and its subsidiaries was less than $288,839.00 on December 31, 1968. The Court finds therefore no material breach

of subparagraph (L) of Section 1 of the June 16, 1969, agreement.

Finder's Fee

The defendant alleges that in violation of §12 of the June 16, 1969, agreement, the plaintiffs failed to disclose that a finder's fee was paid to Leonard Marks. The evidence shows that *both* the GHO shareholders and Rollins paid a finder's fee to Mr. Marks. Each party paid its own fee, and no claims have been asserted by Mr. Marks. Therefore, I find no breach of §12 of the agreement.

Agreed Reduction

Defendant contends, and the evidence supports a finding, that plaintiff Milton Staub agreed on behalf of the former GHO shareholders to a reduction of the debentures. In a letter of agreement of January 6, 1971, Staub warranted that a minimum of $61,000.00 would be collected on specified accounts receivable. The agreement authorized a reduction of the debentures, in the event the amount collected by December 31, 1971, was less than $61,000.00, in direct proportion to the deficiency. The shareholders ratified Staub's agreement in a February 3, 1971, letter to Rollins. The actual amount collected prior to December 31, 1971, was $52,214.58. The total debenture reduction agreed to in the January 6, 1971, agreement, therefore, was $8,785.42. Staub's allocable portion (46.86359%) of this reduction is $4,117.16. Hirsch's allocable portion (44.497%) of this reduction is $3,909.25. Thus, as of January 1, 1972, the outstanding debentures should have been in the face amounts of $561,673.84, held by Staub, and $552,303.75 held by Hirsch.

III

I turn now to the defendant's counterclaim under Rule 10(b)-5 and Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b). The defendant alleges that the items previously discussed on the December 31, 1968, financial statement and the June 16, 1969, agreement concerning the assets and liabilities of GHO and its subsidiaries constituted misrepresentations of material fact in violation of Rule 10(b)-5 and Section 10. In addition the defendant alleges that the plaintiffs failed to disclose certain material facts which were necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading. The Court is satisfied that the defendant's evidence establishes a sufficient interstate nexus to establish jurisdiction by reason of the communications between the parties leading up to and following the June 16, 1969, agreement. The plaintiffs have raised certain affirmative defenses to the securities fraud action alleged by the defendant.

The plaintiffs first raise estoppel, waiver and laches as defenses to the defendant's counterclaim. Each of these defenses is an affirmative defense, and the burden is upon the plaintiffs to show by a preponderance of the evidence that the defenses are applicable to this action. Although certain disputes between the parties have been resolved through the termination of the escrow agreement and by consent reductions in the debentures, the Court finds that the defendant did not thereby waive the subsequent fraud claim arising out of the same or similar transactions. The only prejudice to plaintiffs which has been demonstrated would arise only in the event that rescission of the agreement is ordered. The Court finds that the positions of the parties have been so changed, as a result of their own actions, that it would be impossible to rescind the agreement and restore the parties to their positions

prior to the acquisition. The plaintiffs' evidence fails to support a finding that the plaintiffs were in any other way prejudiced by the actions of the defendant or the delay in the assertion of its fraud claim. Thus the defenses of estoppel and laches are unavailable.

The plaintiffs have also asserted that the statute of limitations acts as a bar to the defendant's federal securities fraud claim. Although the June 16, 1969, agreement and the debentures issued thereunder provide that they are to be interpreted and controlled by the law of the state of Delaware, the alleged misrepresentations and omissions which form the basis of the defendant's securities fraud claim occurred in Ohio. Since the federal securities fraud cause of action is separate and distinct from the agreement and debentures, and since it arose in Ohio, the defendant's counterclaim is controlled by the applicable Ohio statute of limitations. The applicable Ohio statute is R.C. 2305.09 which provides for a four-year period of limitations. See *Nickels v. Koehler Management Corp.*, 541 F.2d 611 (6th Cir. 1976). It is well established that the period of limitation begins to run when the facts which would amount to fraud are discovered, or should have been discovered in the exercise of reasonable diligence. Since the statute of limitation is an affirmative defense, the burden in this case is on the plaintiff to show by a preponderance of the evidence the date upon which the period of limitations should have started to run. The Court believes the plaintiffs have met this burden with respect to the Incore tax matters and the Port Huron contract. In a November 13, 1969, memorandum from Jerry Shea[4] to Chuck Dey, the defendant's vice president

---

4. Jerry Shea is an accountant who was hired by Rollins management to oversee GHO's accounting. Robert Shertz, then

(Continued on following page)

and treasurer, the facts surrounding the Incore income tax matter which the defendant asserts as part of its fraud claim were fully disclosed. The Court also finds that the facts concerning the Port Huron paper mill, upon which the defendant relies, should have been discovered in the exercise of reasonable diligence in September of 1969. By this time, Vogel Electric Company had ceased to perform, Aetna had discontinued funding the project, and Incore had taken over and completed the contract. With respect to the remaining allegations of misrepresentations and omissions, the Court finds that the plaintiffs have failed to sustain their burden of proof. The preponderance of the evidence does not establish that the factual bases of the defendant's allegations were known or should have been known to the defendant in excess of four years prior to the assertion of the present securities fraud claim.

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78(j)(b), provides that it shall be unlawful for any person "to use or employ . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." The Commission has promulgated Rule 10(b)-5, 17 C.F.R. §240.10b-5, which provides

> It shall be unlawful for any person directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

---

Footnote continued—

executive vice-president and now vice-chairman of the defendant testified that Shea was intended to be named as comptroller of GHO, but was never appointed due to a conflict with Milton Staub. Dey testified that Shea had staff responsibility to the Rollins accounting department and reported directly to Dey on some occasions.

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

The Supreme Court has recently held that the private cause of action created by §10b and Rule 10b-5 requires a showing of "scienter" or an intent to deceive, manipulate, or defraud. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

The Court has previously discussed many of the alleged misrepresentations and omissions by the plaintiffs in the context of the warranties contained in the June 16, 1969, agreement. Where the Court has found that the actions of the plaintiffs did not constitute a breach of warranty or misrepresentation in the June 16 agreement, the Court finds that the same actions by the plaintiffs cannot support a claim of misrepresentation or omission under the defendant's counterclaim for securities fraud. A securities fraud action requires a material misrepresentation or omission. Where there has been no material misrepresentation or omission, an action for securities fraud must fail.

With respect to the alleged misrepresentations and omissions not previously discussed herein, the Court finds that the defendant's evidence fails to support a finding of scienter on behalf of the plaintiffs or Irene Hirsch.

From the evidence, the Court simply cannot conclude that there was any intent to deceive, manipulate or defraud on the part of the plaintiffs or their predecessor in interest. The evidence establishes that the defendant had participated in several corporate acquisitions prior to the acquisition of GHO. The defendant had available to it the reports of its own employees of their investigation and inquiries, a review of Gustav Hirsch organization prepared by McKinsey & Company, Inc., and the Price Waterhouse & Company acquisition audit. These reports included questionable and negative aspects of GHO and its subsidiaries as well as the affirmative aspects. The extensive Price Waterhouse audit, for example, was submitted with a disclaimer opinion. That is, the auditors were unable to render an opinion on the accuracy of the December 31, 1968, financial statements. The reasons given for the auditors' disclaimer included certain questionable accounts and the inadequacy of pre-1968 records. In fact, based upon these reports, one of the defendant's officers advised against the GHO acquisition. The Court believes that these reports present a fairly true and accurate picture of GHO and its subsidiaries as of the time that they were prepared. Their reports clearly put the defendant on notice that there was a substantial down-side risk to the GHO acquisition.

The defendant contended at trial that Milton Staub represented that certain accounts receivable carried on the financial statements of GHO on December 31, 1968, were fully collectible. The defendant further contends that it relied upon and was misled by Staub's alleged representations. The plaintiffs argued that Staub's statements concerning the collectibility of the questioned accounts receivable were merely opinions that the accounts receivable were proper assets for inclusion upon the financial statements, and that he felt they would be col-

lected. Regardless of how the Staub statements are characterized, the Court finds no evidence to support a finding that the statements were made with an intent to deceive or defraud the defendant. While the evidence shows that all of the accounts receivable were not ultimately fully realized, the evidence does not show that Staub knew or should have known that the accounts were uncollectible or that the statements were made in order to mislead the defendant.

The defendant also contends that the failure of the plaintiffs to advise the defendant of the existence of the previously discussed White Motor Company invoice constituted a material omission. While the removal of the White Motor Company invoice from the GHO books may well have constituted negligence, the Court does not believe that it was a material omission made with the intent to defraud or deceive the defendant. The evidence does not show that the plaintiffs or Irene Hirsch knew of the existence of the White Motor Company invoice or of the reason for its removal from the GHO books.

Although serious questions are raised by certain transactions such as the Incore income tax matters, the Court finds insufficient evidence to support a finding that GHO, its officers, or any of the plaintiffs espoused a policy of commercial bribery in the operation of the business of GHO or its subsidiaries. Another alleged example of a policy of commercial bribery was the Tujax Garfunkel invoices. Plaintiffs admit that certain invoices, such as the October 1971 invoice for $26,101.30, were issued and paid for material which was not intended to be delivered. Milton Staub testified that this invoice was to settle certain outstanding accounts with Tujax Garfunkel, some of which had been open since 1964. Staub explained that the invoice was charged to a fixed-price contract and would

not therefore damage the owner. The invoice was not charged to the contracts upon which the expenses had actually been incurred because those contracts had long since been closed. The Court agrees with the defendant that this procedure may well be an improper method of settling outstanding accounts. I cannot agree, however, that it is evidence which supports an inference that GHO engaged in a practice of commercial bribery. At most, this evidence would support a finding of negligent bookkeeping occurring over two years after the Rollins acquisition. The evidence simply does not support a finding that the plaintiffs omitted to disclose information concerning the alleged policy of commercial bribery with an intent to deceive or defraud the defendant.

With respect to Irene Hirsch the evidence shows only that she was a major shareholder in GHO and a director. There is no evidence that she was actively involved in the negotiations with Rollins, had any opportunity to make misrepresentations, or was in a position to be charged with misleading omissions.

Conclusion

In summary, the Court finds that the acquisition of GHO by Rollins was entered into by individuals and corporations sophisticated in such matters, with a reasonably accurate disclosure of material information. Many of the matters raised and complained of by the defendant are matters in which there may well be a reasonable difference of business judgment. In addition, many of the events complained of occurred long after the acquisition was completed. The facts of this case indicate that the acquisition of GHO carried with it certain advantages and the likelihood of certain losses and down-side risk. The fact that the defendant may have made different business judgments

based upon hindsight does not, by itself, support a claim for securities fraud. The actions of the defendant indicate a decision to take advantage of the up-side potential, and to assume the down-side risk. The Court further believes that the present financial position is largely attributable to known pre-existing conditions and the operation of GHO by Rollins after the acquisition, and not to the actions of plaintiffs before or after the sale. For the reasons stated above, the Court has determined that the facts and the law do not entitle the defendant to relief upon its claim of securities fraud violations.

The defendant has also counterclaimed alleging common law fraud. Because the Court has found no material misrepresentations or omissions, and a lack of fraudulent intent, this claim must also fail.

The Court has found no evidence of fraud committed by Irene Hirsch either under the statutory scheme of the Securities Act or under common law doctrines. There is no basis, therefore, to void the defendant's guarantee of the GHO obligations to Irene Hirsch. Nor does the Court find that this is an appropriate case to impose an equitable subordination of the GHO obligation to Hirsch to the GHO obligation to Rollins.

The Court has found that the plaintiffs breached certain warranties contained in the June 16, 1969, agreement. The Court has also found, however, that these breaches, either separately or jointly were not substantial breaches in light of the totality of circumstances. The Court specifically finds that the plaintiffs have substantially performed their part of the agreement. The plaintiffs' breaches do not therefore entitle the defendant to rescind, nor do they excuse the defendant's duty to perform in accordance with its agreement. Equity does require that the damages incurred by defendant as a result of plaintiffs' breaches

be offset from plaintiffs' recovery. This setoff places both parties in the position that full performance of the contract would have put them. The Court determines the amount of the setoff to be the actual dollar amount of the undisclosed or non-business liabilities relating to the Incore tax matter and White Motor Company. No evidence adduced at trial affords a basis for any other calculation of defendant's damages. Nor does the evidence support an award of consequential damages.

In accordance with the foregoing opinion, the Court finds the issues in the plaintiff's complaint in Case No. C-2-74-163 joined in favor of the plaintiff and against the defendant. The Court further finds the issues in the defendant's counterclaim joined in favor of the plaintiff and against the defendant. The Court computes and awards plaintiff Milton Staub damages as follows: $561,673.84 representing the principal amounts of debentures in default plus interest accrued and payable to July 1, 1976, in the amount of $51,359.83, less a setoff of $53,538.92, for a total award of $559,494.75. The setoff is made herein against the plaintiff's recovery as damages awardable to the defendant for the plaintiff's breach of certain contract warranties in the June 16, 1969, agreement. The setoff is the allocable proportion (46.8635%) of damages awardable to the defendant in the total amount of $114,244.40. These damages include $6,627.72 for tax reimbursement claims of George Murphy, $18,973.76 tax reimbursement claim of Donald Jansen, $45,295.72 tax deficiency assessed against Incore Electric Company, and $43,347.20 for the White Motor Company unrecorded invoice.

In Case No. C-2-74-249 the Court finds the issues in the plaintiffs' complaint joined in favor of the plaintiffs and against the defendant. The Court further finds the issues in the defendant's counterclaim joined in favor of

the plaintiffs and against the defendant. The Court finds and awards damages to the plaintiffs as follows: $552,-303.75 representing the principal amount of debentures in default, plus $48,984.22 representing accrued interest payable to July 1, 1976, less a setoff of $50,835.33, for a total damage award to the plaintiffs of $550,452.64. The setoff made herein represents the plaintiffs' allocable proportion (44.497%) of the $114,244.40 damages awardable to the defendant as discussed hereinabove in connection with Case No. C-2-74-163.

Plaintiffs in each case are further entitled to interest at the rate of six percent (6%) per annum on all unpaid interest from the time that each payment was due, and on the principal from the date of demand following default. Costs will be awarded pursuant to Fed. R. Civ. P. 54(d).

The plaintiffs shall prepare a proposed judgment in accordance with the Court's foregoing findings of fact and conclusions of law, within ten (10) days of the entry of this opinion. Defendants shall have five (5) days after the proposed judgment is filed to respond.

It is so ORDERED.

/s/ ROBERT M. DUNCAN
Robert M. Duncan, *Judge*
United States District Court

MEMORANDUM AND ORDER OF THE UNITED STATES DISTRICT COURT

(Filed October 11, 1977)

No. C2-74-163

THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

MILTON STAUB,
Plaintiff,

vs.

ROLLINS INTERNATIONAL, INC.,
Defendant.

No. C2-74-249

THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

THE OHIO NATIONAL BANK OF COLUMBUS, AND JOHN L. DAVIES, EXECUTORS OF THE ESTATE OF IRENE D. HIRSCH, DECEASED,
Plaintiffs,

vs.

ROLLINS INTERNATIONAL, INC.,
Defendant.

This matter is before the Court upon its own motion to reconsider the computation of damages set forth in the Court's Opinion of September 8, 1977.

In Case No. C-2-74-163 damages shall be computed and awarded to plaintiff Milton Staub as follows: $561,673.84 representing the principal amount of debentures in default plus interest accrued and payable to the date of default, less a set-off of $53,538.92.

In Case No. C-2-74-249 the plaintiff's damages shall be computed and awarded as follows: $552,303.75 representing the principal amount of debentures in default, plus interest accrued and payable to the date of default, less a set-off of $50,835.33.

Plaintiffs in each case are further entitled to interest at the rate of six per cent (6%) per annum on all unpaid interest from the time that such payment was due until the date of default, and on the principal from the date of demand following default until paid.

To the extent that the foregoing computation and award of damages is inconsistent with the Court's Opinion of September 8, 1977, the inconsistent provisions of the September 8 Opinion are hereby VACATED and held for naught.

So ORDERED.

/s/ ROBERT M. DUNCAN
Robert M. Duncan, *Judge*
United States District Court

MEMORANDUM AND ORDER OF THE UNITED STATES DISTRICT COURT

(Filed April 25, 1978)

No. C2-74-163

THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

MILTON STAUB,
Plaintiff,

VS.

ROLLINS INTERNATIONAL, INC.,
Defendant.

No. C2-74-249

THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

THE OHIO NATIONAL BANK OF COLUMBUS, AND JOHN L. DAVIES, EXECUTORS OF THE ESTATE OF IRENE D. HIRSCH, DECEASED,
Plaintiffs,

VS.

ROLLINS INTERNATIONAL, INC.,
Defendant.

An Opinion was rendered in these cases on September 8, 1977, and amended by the Court's Memorandum and Order of October 11, 1977. Thereafter, a dispute arose among the parties concerning the computation of damages. The Court has received letters from counsel setting forth

their views on the proper method of computing damages. The Court will cause these letters to be placed in the Court's files and to become a part of the record in these actions. The Court's computation and award of damages is set forth herein.

In its Opinion of September 8, 1977, as amended October 11, 1977, the Court found that the defendant was in default on the debentures for failure to pay interest. The Court found that the plaintiffs are entitled to the amount of unpaid interest due at each installment until the date of plaintiff's demand for payment following default. On the date of demand following default, the principal amount of the debentures became due and payable.

While holding that the defendant was not entitled to unilaterally reduce the principal amount of the debentures, the Court did find that the defendant is entitled to damages in the form of a set-off arising from plaintiffs' breach of certain warranties in the June 16, 1969, agreement. The Court also found that the plaintiffs agreed to a reduction in the principal amount of the debentures as of January 1, 1972.

The basic dispute among the parties concerns the time at which the set-off is to be applied. The plaintiffs contend that the set-off should be applied to the principal amount plus accrued interest as of July 1, 1976. The defendant argues that the set-off should be applied to the principal amount of the debentures as of July 1, 1969, when they were issued. The Court cannot agree with plaintiffs since the application of the set-off against the principal and interest due on July 1, 1976, would deny interest to the defendant on the damages to which it is entitled for breach of warranties in 1969. Nor can the Court agree with the defendant since the Court has previously held that the

plaintiffs' breach did not authorize a reduction of the principal of the debentures.

The counterclaims upon which the defendant prevailed are separate and distinct from the claims upon which the plaintiffs are entitled to recover. By the use of the term "set-off" in its Opinion of September 8, 1977, the Court merely meant that the defendant's damages may be mathematically deducted from the plaintiffs' damages at the time of satisfaction of this judgment.

The Court has also considered the plaintiffs' contention that pre-judgment interest be compounded, and finds it to be without merit. The Court awards pre-judgment interest at the simple rate of six per cent (6%) without compounding.

Thus, plaintiffs are entitled to judgment for the amount of interest on the debentures due but not paid for each semi-annual installment up to the date of demand following default (Staub—February 8, 1974, Hirsch—February 19, 1974). The plaintiffs are entitled to interest on these unpaid amounts at a rate of 6% simple from the date each payment was due until paid. As of the date of demand, plaintiffs became entitled to full payment of the principal of the debentures. The principal amount of the debentures accrues interest at the rate of 6% simple from the date of demand until paid.

The defendant is entitled to recover damages in Case No. C-2-74-163 in the amount of $51,711.01 plus 6% simple interest from July 1, 1969, until paid. In Case No. C-2-74-249 defendant shall recover $50,835.33 plus 6% simple interest from July 1, 1969, until paid. As a result of the agreed reduction of the principal amount of the debentures as of January 1, 1972, the defendants made interest payments on July 1, 1972, and January 1, 1973, in excess

of the amounts then due. The defendant is further entitled to judgment for the amount of each overpayment from the date paid with interest at the simple rate of 6%.

The following tables reflect the Court's computation of damages:

Table 1—Case No. C-2-74-163

Principal

Principal as of 1/1/74	$561,814.41
Interest at 4% 1/1/74-2/8/74	2,421.08
Interest at 6% 2/8/74-6/30/74	13,113.70
Total amount due as of 6/30/74	$577,349.19
Amount paid 6/30/74	10,614.28
Total amount due as of 7/1/74	$566.734.91

Interest	Interest Due	Paid	Balance Paid
6/30/72	$11,236.29	$11,315.82	$ (79.53)
12/31/72	11,236.29	11,315.82	(79.53)
6/30/73	11,236.29	9,245.97	1,990.32
12/31/73	11,236.29	7,414.28	3,822.01

Damages for breach of warranties, July 1, 1969—$51,711.01

Table 2—Case No. C-2-74-249

Principal

Principal as of 1/1/74	$552,203.75
Interest at 4% 1/1/74-2/19/74	3,051.40
Interest at 6% 2/19/74-6/30/74	11,893.49
Total amount due 6/30/74	$567,248.64
Amount paid 6/30/74	10,620.26
Total amount due as of 7/1/74	$556,628.38

Interest	Interest Due	Paid	Balance Due
6/30/72	$11,046.07	$11,124.26	$ (78.19)
12/31/72	11,046.07	11,124.26	(78.19)
6/30/73	11,046.07	7,097.22	3,948.85
12/31/73	11,046.07	10,620.86	425.21

Damages for breach of warranties, July 1, 1969—$50,835.33

Judgment will enter as set forth hereinabove. Each party shall bear his or its own costs.

So ORDERED.

/s/ ROBERT M. DUNCAN
Judge
United States District Court

JUDGMENT ENTRY OF THE UNITED STATES DISTRICT COURT

(Filed April 25, 1978)

No. C2-74-163

THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

MILTON STAUB,
Plaintiff,

vs.

ROLLINS INTERNATIONAL, INC.,
Defendant.

In accordance with the Court's Opinion of September 8, 1977, as amended by the Court's Memorandum and Order of October 11, 1977, the Court awards damages as follows:

(1) The plaintiff shall recover from the defendant $566,734.91 plus interest on this amount at the annual rate of six percent (6%) simple interest from July 1, 1974, until paid. Plaintiff is further entitled to $1,990.32 plus six percent (6%) simple interest from July 1, 1973, until paid, and $3,822.01 plus six percent (6%) simple interest from January 1, 1974, until paid.

(2) Defendant shall recover damages from plaintiff in the amount of $51,711.01 plus six percent (6%) simple interest from July 1, 1969, until paid. Defendant shall further recover $79.53 plus six percent (6%) simple interest from July 1, 1972, until paid, and $79.53 plus six

percent (6%) simple interest from January 1, 1973, until paid.

Each party shall bear his or its own costs.

/s/ ROBERT M. DUNCAN
Judge
United States District Court

JUDGMENT ENTRY OF THE UNITED STATES DISTRICT COURT

(Filed April 25, 1978)

No. C2-74-249

THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

THE OHIO NATIONAL BANK OF COLUMBUS, AND JOHN L. DAVIES, EXECUTORS OF THE ESTATE OF IRENE D. HIRSCH, DECEASED,
Plaintiffs,

VS.

ROLLINS INTERNATIONAL, INC.,
Defendant.

In accordance with the Court's Opinion of September 8, 1977, as amended by the Court's Memorandum and Order of October 11, 1977, the Court awards damages as follows:

(1) The plaintiffs shall recover from the defendant $556,628.38 plus interest at the annual rate of six percent

(6%) simple interest from July 1, 1974, until paid. Plaintiffs are further entitled to $3,948.85 plus six percent (6%) simple interest from July 1, 1973, until paid, and $425.21 plus six percent (6%) simple interest from January 1, 1974, until paid.

(2) Defendant shall recover from plaintiffs in the amount of $50,835.33 plus six percent (6%) simple interest from July 1, 1969, until paid. Defendant shall further recover $78.19 plus six percent (6%) simple interest from July 1, 1972, until paid, and $78.19 plus six percent (6%) simple interest from January 1, 1973, until paid.

Each party shall bear his or its own costs.

/s/ ROBERT M. DUNCAN
Judge
United States District Court

ORDER OF THE COURT OF APPEALS FOR THE SIXTH CIRCUIT

(Filed September 30, 1980)

Nos. 78-3562/3/4

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

MILTON STAUB, THE OHIO NATIONAL BANK OF COLUMBUS, AND JOHN L. DAVIES,
Plaintiffs-Appellees, Cross-Appellant,

v.

ROLLINS INTERNATIONAL, INC.,
Defendant-Appellant Cross-Appellee.

ORDER

Before: KEITH and MERRITT, *Circuit Judges*, and WISEMAN, *District Judge**

Plaintiffs-Appellees brought this breach of contract action against Defendant-Appellant Rollins International, Inc. (the Company) before Judge Robert M. Duncan in the Southern District of Ohio. The Company alleged several defenses and counterclaims based on common law fraud, on Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §783(b) and Rule 10(b)-5, and on the terms of the contract of sale between the parties. In a well-reasoned and meticulous opinion by Judge Duncan, the district court ruled that Plaintiffs-Appellees had substantially performed their part of the agreement for acquisition of the Gustav Hirsch Organization (GHO),

---

*Hon. Thomas A. Wiseman, Jr., Judge, United States District Court for the Middle District of Tennessee, sitting by designation.

and that most of the Company's defenses and counterclaims were meritless. However, the district court did allow the Company set-offs against plaintiffs' recovery because of Plaintiffs-Appellees breach of certain warranties in the sales agreement. The Company appealed the decision, and Plaintiff-Appellee cross-appealed.

The Company presents several grounds for reversal.

First, it contends that it is entitled to a complete defense to Plaintiff's claims as well as to affirmative recovery because of material misrepresentations and omissions made by the sellers of GHO. The Company rests its contention on common law fraud doctrines and §10(b) of the Securities and Exchange Act, however the district court correctly found that there was no failure by the sellers to disclose material facts before the acquisition. *See e.g. Chelsea Associates v. Rapanos*, 527 F.2d 1266 (6th Cir. 1975), *Arber v. Essex Wire Corp.*, 490 F.2d 414 (6th Cir. 1974), and *Britt v. Cyril Bath Co.*, 417 F.2d 433 (6th Cir. 1969).

Second, the Company contends that the district court's exclusion of certain testimony on hearsay grounds was prejudicial error, because the statements fall under the verbal acts exception to the hearsay rule codified in Federal Rules of Evidence 804. The district court correctly found that the statements do not fall within the exception, since the making of the statements did not constitute a relevant fact regardless of the truth or falsity of the assertion.

Accordingly, for these reasons and the reasons stated in the comprehensive opinion of the district judge, the judgment of the court below is affirmed.

Entered by Order of the Court
/s/ JOHN P. HEHMAN
Clerk

No. 80-1078

In the Supreme Court of the United States

October Term, 1980

ROLLINS INTERNATIONAL, INC.,
Petitioner,

vs.

MILTON STAUB AND THE OHIO NATIONAL BANK OF COLUMBUS, *et al.*,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

JOHN L. DAVIES (*of counsel*)
JOHN A. CARNAHAN
KNEPPER, WHITE, ARTER & HADDEN
180 East Broad Street
Columbus, Ohio 43215
(614) 221-3155
Counsel for Respondents

THE GATES LEGAL PUBLISHING CO., CLEVELAND, OHIO—TEL. (216) [illegible]-6647

QUESTION PRESENTED

Respondents believe that there is no legitimate question presented for review by this Court in accordance with the requirements of its Rule 17(c). Petitioner presupposes, in its Petition, that Respondents, in connection with their management and control of GHO, "had for some time been engaged in a course of commercial bribery" (p. 3 of Petitioner's brief), when in fact there was no such finding by the District Court, as a matter of either fact or law.

TABLE OF CONTENTS

Question Presented I
Table of Authorities III
Statement of the Case 1
Argument 3
Conclusion 4

Table of Authorities

Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) 3

PREVIOUS PAGE WAS BLANK

No. 80-1078

In the Supreme Court of the United States

October Term, 1980

ROLLINS INTERNATIONAL, INC.,
Petitioner,

vs.

MILTON STAUB AND THE OHIO NATIONAL BANK OF COLUMBUS, *et al.*,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

STATEMENT OF THE CASE

Respondents, of course, do not accept Petitioner's repeated charge that Respondents somehow engaged in a course of "commercial bribery" justifying the granting of relief under §10(b) to Petitioner. The District Court rejected that argument in what the Court of Appeals for the Sixth Circuit characterized as a "well-reasoned and meticulous opinion," and of course the latter court affirmed the findings and conclusions of the District Court.

Respondents point out that (1) each of those practices and occurrences upon which Petitioner apparently places such great emphasis was weighed and considered by the District Court and rejected by it as a basis for §10(b) relief; (2) Petitioner is a sophisticated company with broad experience in the acquisition of other enterprises; (3) Petitioner employed an independent Big Eight accounting firm to audit GHO's financial records and those of its subsidiaries, and that audit was carried out in a time-consuming and thorough fashion; (4) the audit report set forth a "disclaimer" which, according to Petitioner's own vice president and treasurer, would cause him to proceed with caution on Petitioner's behalf; (5) in fact, he did advise Petitioner that the acquisition of GHO by Petitioner would not be a "good deal" for it, but, despite such advice, it proceeded with the transaction; (6) the resignation of Leonard Weakley as counsel for GHO's subsidiary, Incore—an occurrence upon which Petitioner attempts to lay such great weight—was an action initiated by neither GHO nor Incore, and, in any event, produced no additional liabilities for either; and (7) GHO's downfall—the apparent inspiration for Petitioner's §10(b) claims—came about not because of any misrepresentations or fraud on Respondents' part but because of Petitioner's own mismanagement and ineptitude.

All of these points were thoroughly presented, briefed and argued in the District Court and the Court of Appeals. Both properly concluded that there simply is nothing in the record to support Petitioner's §10(b) claims.

ARGUMENT

Petitioner argues that the question "of great importance on which this Court has made no direct pronouncement is the materiality of domestic corrupt business practices within the disclosure requirements of §10(b) . . . and Rule 10b-5 thereunder." The immediate and conclusive response to that is that there was no *finding* by the District Court that Respondents engaged in any course of "corrupt business practices." On the contrary, in dealing with the occurrences upon which Petitioner lays such great emphasis, the Court specifically found that there had been no material misrepresentations, omissions or fraudulent intent. (See, *e.g.*, the portions of the District Court's opinion set forth on pages A36-A39 of Petitioner's brief.)

More specifically, regardless of how one characterizes the acts of which Respondents complain, the District Court found that Petitioner's evidence failed to support a finding of any scienter on Respondents' part necessary to support a §10(b) claim under the pronouncement of this Court in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). The Court of Appeals agreed.

In sum, therefore, Petitioner has not met the criterion set forth in Rule 17(c) of this Court's rules. There is no "important question of federal law" which should be settled by this Court. To find otherwise would be to require this Court to re-try the issue of whether or not there was "commercial bribery" on Respondents' part—a procedure certainly not within the purview of Rule 17. Furthermore, this Court has decided in *Hochfelder* that scienter is a necessary element to support a §10(b) claim. In view of the conclusions of both lower courts that, however one characterizes the acts of Respondents about which Petitioner complains, that element is lacking, there simply is no basis upon which this Court can grant certiorari.

CONCLUSION

There being no important question of federal law which this Court should settle within the meaning of Rule 17(c) of the Rules of this Court, Petitioner's Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

JOHN L. DAVIES (*of counsel*)
JOHN A. CARNAHAN
KNEPPER, WHITE, ARTER & HADDEN
180 East Broad Street
Columbus, Ohio 43215
(614) 221-3155
Counsel for Respondents